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BEFORE THE
SURFACE TRANSPORTATION BOARD

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In the Matter of:	)	
RAILROAD COST RECOVERY PROCEDURES - PRODUCTIVITY ADJUSTMENT	)	Ex Parte No. 290 (Sub-No. 4)
QUARTERLY RAIL COST ADJUSTMENT FACTOR	)	Ex Parte No. 290 (Sub-No. 5) (2010-2)

OPENING COMMENTS OF THE WESTERN COAL TRAFFIC LEAGUE

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OPENING COMMENTS OF THE WESTERN COAL TRAFFIC LEAGUE

In response to the Board's Notice in the above-captioned proceedings served June 11, 2010 (the "Notice"), the Western Coal Traffic League ("WCTL")[1] submits the following Opening Comments.

The Board's Notice seeks comments regarding the request of the Association of American Railroads ("AAR") that the Board restate the previously published productivity adjustment for the 2003-2007 averaging period, otherwise known as the 2007 productivity adjustment, to track the 2007 productivity adjustment as calculated in STB Ex Parte No. 290 (Sub-No. 4), *Railroad Cost Recovery Procedures--*

[1] WCTL is a voluntary association, whose regular membership consists entirely of utility shippers of coal mined west of the Mississippi River that is transported by rail. WCTL members presently ship and receive in excess of 140 million tons of coal by rail each year. WCTL's members include: Ameren Energy Fuels and Services, Arizona Electric Power Cooperative, Inc., Austin Energy (City of Austin, Texas), CLECO Corporation, CPS Energy, Kansas City Power & Light Company, Lower Colorado River Authority, MidAmerican Energy Company, Minnesota Power, Nebraska Public Power District, Omaha Public Power District, Texas Municipal Power Agency, Western Farmers Electric Cooperative, Western Fuels Association, Inc., Wisconsin Public Service Corporation, and Xcel Energy.

Productivity Adjustment (STB served March 26, 2010) ("*2008 Productivity Adjustment*"), establishing the 2008 (2004-2008) productivity adjustment. More specifically, the AAR seeks restatement of any past quarterly RCAF-A and RCAF-5 values to conform to the recalculation of 2007 productivity in *2008 Productivity Adjustment.*[2]

On numerous occasions in the past, WCTL has requested that the Board correct its published values for such matters as the RCAF, the cost of capital, *etc.*, to improve the accuracy of those values. The AAR has generally opposed such efforts by WCTL, and the Board, including its statutory predecessor, has generally sided with the AAR in such matters. The Board's typical explanation has been along the lines that the claimed need for accuracy must somehow give way to settled expectations.

Numerous examples abound. The most recent is the Board's steadfast insistence on calculating the 2005 cost of equity using a single-stage Discounted Cash Flow model, notwithstanding WCTL's strong demonstration that a calculation using the Capital Asset Pricing Model ("CAPM") would be more accurate.[3] Earlier examples

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[2] WCTL assumes for present purposes that the Board's revised calculation of 2007 productivity in *2008 Productivity Adjustment* is correct. WCTL cannot confirm the correctness of the calculation because the Board does not make the unmasked waybill available to shippers. That said, WCTL notes that in 2007, the Board initially calculated the output index value at 1.000, the value that the Board depicts as being correct in *2008 Productivity Adjustment*, but that the Board adopted the 1.014 output index value for 2007 only in response to comments filed by the AAR. *See* Ex Parte No. 290 (Sub-No. 4), *Railroad Cost Recovery Procedures-Productivity Adjustment* (STB decisions served Feb. 5, 2009, and March 20, 2009).

[3] *See* STB Ex Parte No. 558 (Sub-No. 9), *Railroad Cost of Capital* (STB decisions served Sept. 20, 2009, and Feb. 12, 2007), *pet. for rev. dismissed without prejudice sub nom. Western Coal Traffic League v. STB*, 264 F. App'x 7 (D.C. Cir. 2008). *See also AEP Texas North Co. v. STB* (D.C. Cir. No. 09-1202, June 18, 2010) (holding that Board had

include: (a) the agency's refusal to adjust the RCAF for accumulated historical productivity when the agency first adopted the productivity adjustment,[4] (b) the agency's initial refusal to order RCAF-based rates to decrease when the RCAF declined,[5] and (c) even when it eventually agreed that rates should be rolled back in response to RCAF decreases, the agency's imposition of a floor on such rate decreases, and the agency's refusal to make any adjustment for accumulated forecast error.[6]

Of particular relevance is the Board's decision in *Productivity Adjustment-Implementation*, 1 S.T.B. 739 (1996). In that case, the Board appeared to agree with WCTL's premise that the expansion and then sudden contraction of the multi-year averaging period for measuring productivity meant that substantial productivity gains from past years would never be fully incorporated into the RCAF-A values. However, the Board was unwilling to modify the RCAF-A -- even on a current or prospective basis -- to incorporate those otherwise unrecognized past productivity gains. The Board justified its refusal to update the RCAF-A values on its established and judicially upheld policy of not restating RCAF values:

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not adequately explained its refusal to use 2005 CAPM cost of equity figure for stand-alone cost purposes).

[4] *Railroad Cost Recovery Procedures-Productivity Adjustment*, 5 I.C.C.2d 434, 436 (1989), *aff'd sub nom. Edison Elec. Instit. v. ICC*, 969 F.2d 1221 (D.C. Cir. 1992).

[5] Ex Parte No. 290 (Sub-No. 2), *Railroad Cost Recovery Procedures* (ICC decisions decided Apr. 19, 1982, and Nov. 21, 1984).

[6] *Railroad Cost Recovery Procedures*, 3 I.C.C.2d 60 (1986), *aff'd sub nom. Alabama Power Co. v. ICC*, 852 F.2d 1361 (D.C. Cir. 1988).

> Thus, the ICC's judicially approved policy against restating the RCAF to reflect regulatory changes was reasonable when it was first applied; in our view, it is still a reasonable way of measuring cost changes. Accordingly, we see no basis on which to reject the current productivity-adjusted RCAF and replace it with another set of values.

1 S.T.B. at 746. While the Board was willing to establish a new RCAF mechanism, the RCAF-5, that did address the problem of otherwise stranded productivity gains, the Board left it to others to decide whether the RCAF-A or RCAF-5 should apply in any particular situation. The telling point for present purposes is that the Board recognized a shortcoming in its chosen methodology, yet refused to restate its past values to remedy that shortcoming, even on a cumulative, ongoing, and/or prospective basis.

The Board thus departed from its established norms in STB Ex Parte No. 290 (Sub-No. 5) (2010-2), *Quarterly Rail Cost Adjustment Factor* (STB served March 31, 2010) ("*2Q10 RCAF Decision*"), when it published RCAF-A and RCAF-5 values for 2Q10 that corrected for the accumulated overstatement in 2007 productivity recognized in *2008 Productivity Adjustment*. The Board had previously refused to make adjustments for past errors, as noted *supra*. With *2Q10 RCAF Decision*, the Board abruptly changed course and adopted a current value to correct for a past error. Moreover, the Board did so without any notice to the parties, without any discussion of any of its past practices, and without any mention of past precedents eschewing such corrections. Furthermore, the Board did so with respect to the 2007 productivity values, even though the pending proceeding related to the calculation of the 2008 productivity values. The equivalent would be if in considering whether to calculate the 2005 cost of equity using CAPM, the

Board had decided to revisit its calculation of the 2004 cost of equity. There is thus a striking asymmetry between (a) the ease with which the STB made the adjustment to increase the 2Q10 RCAF values to reflect the apparent overstatement of 2007 productivity, and (b) the Board's prior reluctance to restate RCAF values, even for errors that were far more significant, but would have resulted in lower RCAF values.

The AAR's proposal that is the subject of the Board's Notice would go even further and actually restate past RCAF values over a year after the fact. The AAR proposal constitutes a complete deviation from the Board's past practice. The AAR did not identify precedent for such a departure from established practice in its filing, nor did the Board do so in its Notice. Given the Board's past refusal to restate or correct even current values to account for inaccuracy, the lack of discussion of precedent in a notice addressing a restatement of past values is alarming and disturbing. While the restatement proposed may be minimal and arise from an apparently erroneous calculation or use of the wrong data, that hardly provides a basis for refusing to make restatements that are larger in degree and/or more conceptual in scope, such as failing to recognize that index values might fall as well as rise, that giving unequal weight to productivity gains from different years would bias the ultimate incorporation of productivity gains from those years, or that a five-year projection could not be sustained into perpetuity.

The Board's Notice requests specific comment only "on the degree, if any, of detrimental reliance by stakeholders on these previously published figures." This request may be a reference to the agency's past consideration of settled expectations in refusing to adjust RCAF and other published values, although it hardly suffices as an informed discussion of the Board's past practices.

In any event, WCTL notes that reliance on the RCAF productivity calculations takes a number of forms. In particular, the Board ruled in *Major Issues* that stand-alone railroads should be deemed to experience a phase-in of productivity growth as to operating expenses, defined as the difference between the RCAF-U and the RCAF-A, at a rate of 5% per year. In other words, Year 1 operating expenses reflect 95% RCAF-U and 5% RCAF-A, Year 2 operating expenses reflect 90% RCAF-U and 10% RCAF-A, *etc.* The Board's standard stand-alone cost discounted cash flow model thus relies and incorporates the Board's calculation of RCAF productivity-adjusted values, typically as measured by the forecasts prepared by Global Insight.

Second, the RCAF-A is utilized to control railroad rates in Canada. Specifically, when Canadian National Railway ("CN") became the operator of British Columbia Railway Company ("BC Rail"), the Competition Bureau of Canada conducted a comprehensive merger review. As a result of that review CN entered into a Consent Agreement, under which CN is obligated to, *inter alia*, maintain open gateway tariffs, the rates for which are subject to adjustment by the RCAF-A.[7] Obviously, a number of movements handled by CN through BC Rail originate or terminate in the United States, *e.g.*, CN is required to maintain open gateway tariffs with BNSF, Canadian Pacific

[7] The Consent Agreement can be accessed at http://www.competitionbureau.gc.ca /eic/site/cb-bc.nsf/vwapj/261_consent_agreement1.pdf/$file/261_ consent_ agreement1.pdf. The RCAF-A adjustment is noted in paragraph 3.3 (pp. 4-5).

(which has significant operations in the United States), and UP.[8] The open gateway tariffs constitute an additional form of reliance on the RCAF-A values.

Third, while railroads have generally been reluctant for some time to utilize the RCAF-A in their pricing arrangements with shippers, there may still be some existing contracts that utilize the RCAF-A to adjust rates, at least in part. Moreover, even if contracts do not call directly for the RCAF-A or RCAF-5, shippers (including WCTL members), and perhaps even railroads, still make use of those indexes as a benchmark in such matters as determining whether a particular proposal is reasonable,[9] the extent to which changes in rates have tracked or will track changes in costs, whether a particular rate adjustment mechanism is reasonable or appropriate, and what is an appropriate term for a pricing arrangement, *etc*. For example, the Christensen Study prepared for the Board used the RCAF-A in measuring the extent to which changes in rates had tracked changes in costs. Global Insight also publishes a forecast for the RCAF-A, indicating that there is some commercial demand for the information. The RCAF-A and RCAF-5 would also be potentially relevant to the extent that a contract or other pricing arrangement calls for periodic reopening or review of the rate based on cost considerations.

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[8] *See* paragraph 3.2 (p. 4) of the Consent Agreement.

[9] For example, a shipper may consider the RCAF-A in negotiating a discount off of a railroad's standard rate adjustment mechanism or in considering trade-offs such as those among a lower base rate, a less favorable rate adjustment mechanism, and a shorter or longer term.

Accordingly, there is ample evidence of detrimental reliance on the Board's published productivity-adjusted RCAF values by the Board itself for regulatory purposes, by Canada for regulatory/commercial purposes, and by at least shippers, and perhaps railroads, in the United States. Insofar as the Board considers detrimental reliance to be a relevant factor, it weighs against adoption of the AAR's proposal. Beyond that, retroactive restatement would seem to be contrary to the Board's established practice, but if the Board decides to alter its practice, it should do so consistently.

For the reasons stated, WCTL submits that if the Board should decide to adopt the retroactive restatement of RCAF values proposed by the AAR, then the Board should also adopt, on a retroactive basis, the other restatements previously proposed and supported by WCTL and other shippers, especially in light of the Board's authority to reconsider its actions "at any time ... because of material error, new evidence, or substantially changed circumstances" pursuant to 49 U.S.C. § 722(c).

Respectfully submitted,

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